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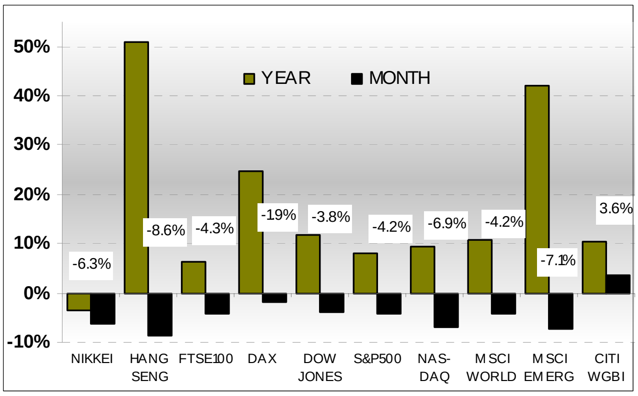
Investment Consulting
Investment Letter | 7th Edition | December 2007

November in perspective – global markets

Phew! What a way to draw a profitable and educative year to a close! The foundation for November's poor returns was laid in August with the onset of a money and credit market crunch and triggered by the crisis in the US sub-prime housing market. Back then, markets lurched sharply lower - by nearly 10% - before more than recovering when the US Federal Reserve lowered its discount rate i.e. the "inter-bank" lending rate. Through September equity markets recovered further, particularly emerging markets, boosted further by a cut in the Fed Fund rate. At that stage it looked like the credit crisis might pass, but since then banks have disclosed massive losses, high-profile hedge funds have collapsed and global liquidity, so necessary for keeping the world's financial system "well-oiled", has dried up. During October and November conditions in the credit and money markets deteriorated further leading to the expectation of greater write-downs by banks and a further tightening in global liquidity. Global equity markets initially reacted as though the crisis would be confined to the credit markets, but an increasing sense of nervousness and distress has overtaken equity markets. Investors realised that they need to be more concerned about the global contagion arising from the current credit crisis. It is not surprising then, that November was an awful month in equity markets. Despite the fact that they recovered in the last week - markets posted their largest weekly gain since March - *markets registered their worst monthly decline since 2002*. There was simply no place to hide, as Chart 1 adequately shows.

Chart 1: Global market returns to 30 November 2007

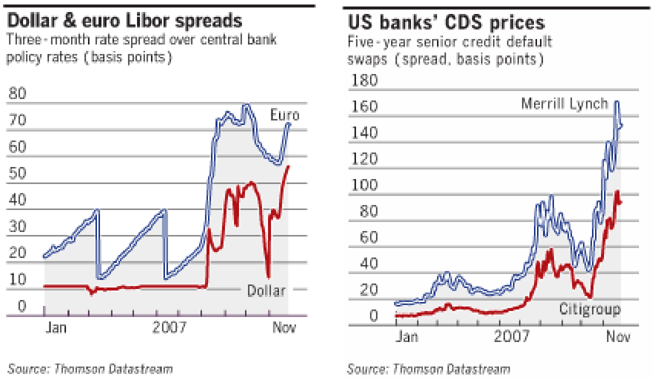


I cannot over-emphasize how volatile the markets have become. Share price movements in excess of 10% have become the order of the day; previously such moves occurred over a month or longer. More than anything else *there is a deep sense of uncertainty in markets*, as investors grapple with the knowledge that the crisis may settle down and turn out to be only a major correction, or could escalate into a *severe, long-lasting crisis* that will affect all markets and asset classes. Banks have been hard hit. Their capital adequacy and solvency has come under pressure as they have been forced to mark-to-market assets in markets where there is just no "bid" i.e. there is simply no market at present for some of these assets. The S&P investment banks sector ended 10.9% on the month; Freddie Mac and Fannie Mae, the government-sponsored mortgage agencies, ended down 33% each; Citigroup, one of the world's largest banks, ended down 21% and Morgan Stanley declined 22%. Home-builders and related industries also suffered; price declines of between 30% and 40% were the order of the day, off an already low base.

Charts of the month

In an effort to elaborate on the credit and money market crisis, the following graphs show how severe the recent movements in these markets have been. Note, too, the deterioration in conditions since August, when the sub-prime crisis first hit the headlines. The chart on the left shows how sharply the cost of inter-bank borrowing has risen, while the right hand chart depicts the cost of insuring against losses (in this case that of Merrill Lynch and Citigroup debt) in the credit market.

Chart 2: Crisis in the credit and money markets



Source: FT.com

Estimates of the total losses arising from this crisis vary. Fed chairman Bernanke first put it at $50bn but then revised his estimate to $150bn. Goldman Sachs recently said they believe a "worst case scenario" would see losses of $445bn from the sub-prime market alone. Add to this the fact that many financial products have been structured around these high-yield instruments and have been *leveraged* further, and then the losses can easily escalate dramatically. Hedge funds are also involved; any crisis in the credit market is bound to affect the normal lending patterns of banks, which in turn will affect healthy firms as the go about their businesses. Without being alarmist, it is not inconceivable to think that losses from the current crisis could rise above $1 trillion. That would put it on a par with the Japanese banking losses of the 1990's and way ahead of previous US financial crises like the Savings and Loans crisis in the 1980's and Long Term Capital Management in 1998. The point here is not to scare you; it is to provide the background against which we will make our investment decisions and to share some of the reasons why we believe the US economy may already be in a recession.

One final point on this topic: I came across a scary fact whilst reading a research this month. We all know that US household debt has risen dramatically over the past few years, which in part has led to the problems described above. But to put the increase in some perspective Merrill Lynch calculated that since late 2001 when the current expansion began, the aggregate household-debt-to-disposable-income ratio surged from 100% to a record 136%. To put that in perspective, in six years the personal sector was able to assume as much debt as the prior forty years combined! Now you know why I often refer to the US as "a land of excess", an attribute that has been instrumental in their continuing downfall as an economic super power.

For the record
Table 1 lists the latest returns of the mutual funds under Maestro's care. You can find more detail, including the latest Maestro Equity Fund Summary, by visiting our website at www.maestroinvestment.co.za. Returns include income and are presented after fees have been charged.

Table 1: Returns of funds under Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity Fund	Nov	**-4.2%**	**25.1%**	**31.1%**
Maestro equity benchmark **		-3.02%	20.1%	27.3%
JSE All Share Index		-3.17%	24.6%	29.8%
Maestro Long Short Equity Fund	Oct	**4.6%**	**5.7%***	N/A
JSE All Share Index		4.8%	11.8%*	N/A
Central Park Global Balanced Fund ($)	Oct	**3.6%**	**14.5%**	**18.5%**
Benchmark***		2.2%	10.6%	13.8%

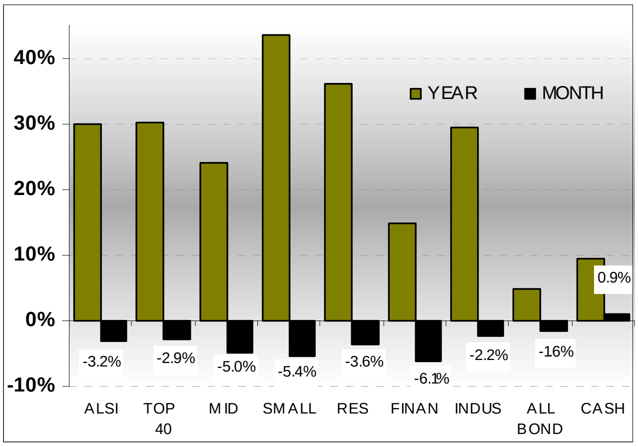
* Since 1 July 2007
** 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index
*** 40% MSCI World Index, 20% each in Citi World Government Bond Index, Credit Suisse Tremont Hedge Index and 3-month US Treasury Bills

A couple of titbits
As usual, here are a few bits of information to keep you abreast of market developments:

- The Indian economy grew 8.9% during the third quarter; the finance minister indicated that he expected GDP growth for the year to end-March to be 9.0%;
- The South African economy grew at 4.7% during the September quarter. The June quarter's growth was revised to 4.4%. Growth for 2006 was revised from 5.0% to 5.4% - the highest growth rate in 25 years;
- SA inflation rose to a four-and-a-half year peak of 7.3%, registering its seventh consecutive month outside the Reserve Bank's target range of 3% - 6%. Food prices, up 12.4%, and energy prices provided the main impetus for the increase. As you are aware by now, the Reserve Bank hiked its repo rate in December, bringing its cumulative increase to 4% since June last year. The prime overdraft rate is now 14.5%.

November in perspective – local markets
In keeping with global equity markets the SA equity market endured a torrid time, which would have been much worse (the All Share index was down over 7% at its worst) had it not been for a late-month rally. Financial shares' 11.2% gain in October set them up for the 6.1% decline in November, but remember that most of the shrapnel in global markets occurred in the financial sector, so the large decline in financials was in keeping with other global markets. Declines occurred along market cap lines; large, mid and small caps declined 2.9%, 5.0% and 5.4% respectively. The mobile telecoms (read MTN) sector rose the most during the month, up 8.6%; the gold index gained 3.7%. Fixed line telecoms declined the most, down 17.8%, reflecting Telkom's sharp loss after it terminated its talks with MTN. The rand came under pressure – it declined 3.8% against a weak dollar and 4.6% against the euro - but SA's high interest rates supported the currency to some extent. Despite the poor November returns, it was only the second time this year that the SA equity market has posted negative monthly returns. Annual returns of the SA equity market are still more than respectable, with the All Share, industrial, basic materials (resources) and small cap indices all still boasting annual returns to end-November in excess of 30%.

Chart 3: Local market returns to 30 November 2007



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File 13: Interesting information, but worth forgetting
Okay, enough of the "heavy stuff" for now. Let's have some fun and look at some interesting trivia. After all, it is the Silly Season, isn't it?

- The dramatic rise in China's stock market has produced a couple of quirks this year, none more so than when its largest integrated oil company, PetroChina, listed in November. Because of the "hot-house" effect - local investors are precluded from investing abroad (sound familiar to SA investors?) - the dramatic surge when the shares were listed resulted in the PetroChina's market cap rising to just over $1 trillion, twice as large as the world's biggest company and integrated oil play, Exxon Mobil. But only 2% of PetroChina is listed in Shanghai in the form of A shares, so one has to suspect that the price is, er … rather "embellished". Valuing PetroChina at its Hong Kong (H-share) price, where another 11.5% is listed, equates to $412bn, less than Exxon's $500bn. But we shouldn't laugh too loudly. As the FT points out last time similar derisory laughs were heard was when the notion of Toyota selling more cars than General Motors was touted - that happened earlier this year.
- And now a few facts surrounding Carlos Slim. "Who" I hear you say? You know – Carlos. Carlos Slim, the richest man in the world. No, that title no longer belongs to Bill or Warren. Yet another prestigious title (like the Webb Ellis rugby champions) has gone to an emerging market! Carlos Slim built his fortune on the back of Telefonos de Mexico (Telmex), Mexico's monopoly fixed lines telecoms company, in which he obtained a controlling stake from government in 1990. A great deal of controversy surrounds Telmex, more specifically its charges and the wealth it has bestowed on the Slim family. Without passing any judgement, I'm sure you will find the following data interesting. Estimated at around $60bn, Slim's wealth is equivalent to 6.6% of Mexico's total GDP. That compares with Bill Gates's wealth ($56bn) at 0.4% of US GDP and John D Rockefeller's at less than 2.0% at its peak. The richest person in the US would need an equivalent of $900bn to possess the same wealth, relative to US GDP, as Carlos Slim's is relative to Mexican GDP. In terms of annual income, using 6% as an income yield, his wealth generates an annual income of $3.6bn. The average annual income of the poorest 10% of Mexicans is $1 200 each, which means that Slim's annual income equals the incomes of 3 million of the poorest Mexicans. Mmm.
- Staying with inequality for the moment, 39 of the 100 richest people are Americans. Their combined wealth amounts to 4.5% of the total US GDP. Fourteen of the 100 richest people are Russians; their combined wealth totals 26% of the total Russian GDP.
- And now for a final display of excess: it had to happen, didn't it? While watching the historic first test flight of the new Airbus A380 with my son last year, I recall wondering how long it would take before an individual placed an order for the plane? Well, at the recent Dubai Airshow, Prince Alwaleed bin Talal became the first person to order an A380 for his own personal use. Did I mention that he flew to the Airshow in his current private jet – a Boeing 747? Priced at a cool $319m, er… before fittings, it is estimated that the latter will cost an additional $200m. The plane is due for delivery in 2010. But let's call a spade a spade – the Prince, who includes amongst other investments, a large stake in Citigroup, must be smarting a bit at the moment, given the company's recent woes. I mean, the share price is off about 40% so far this year. If you were in his shoes, wouldn't you embark on some retail therapy to soothe your pain?

A few last words for the year
As some of you are aware, I recently travelled to Europe and the UK to meet with other investment managers, professional colleagues and other "friends of Maestro". After meeting with them and enquiring how they feel, I don't feel alone in admitting the following: the past six months have been one of the most exhausting periods in my life. I feel as though I have been in a bruising battle throughout this period; a sense of "impending doom" has frequently been evident just "below the surface" as markets have lurched from extreme pessimism to extreme optimism within short periods of time. Returns that were common over a period of months "in the old days" now occur within a single day. Daily price movements of between 5% and 10%, even in very liquid shares, have been common place adding to the sense of nervousness. *Intra-month* declines of 10% in the major indices have given way to recoveries of even greater amounts, adding to the confusion on the part of the casual observer of the market as to "what all the fuss is

about". I have often felt that at times like these experience counts as a distinct *disadvantage*; many managers who adopted the conservative path and tried to protect their client's assets at the extreme moments were *severely* punished by markets – as the latter recovered, so the managers lost out on the recovery. Thus, while they consequently showed negative returns for the month, the indices ended in positive territory – that has to be the worst nightmare of any investment manager. And the room to have made this "error" occurred on more than one occasion in the past few months. It's no wonder I feel like I have aged ten years this year.

2008 as a whole was a very busy year in the Maestro office: we said goodbye to Otto and to Tracy, who served our clients remarkably for three years. We welcomed Vicki and David, who are already "part of the furniture". Sadly, I had to put down my two cats, which as many of you who have visited our office would remember, were "part and parcel of the office". We appointed an independent Compliance Officer and established the Maestro Long Short Equity Fund in July. And last but not least, we managed to secure returns on client portfolios that were in excess of a very strong market. After an exhausting year I am ready to go on leave – I am sure many of you feel exactly the same.

Yet as I look back at all that we achieved and what kept us busy this year, I soon realise that *it would not have been possible without the help of others who for all intents and purposes constitute indispensable parts of Maestro*. I have taken the liberty of listing these firms, firstly to give you an idea of how wide Maestro casts its net and secondly, to register my appreciation to them for the way in which they assist us, often on a daily basis, in managing our client's assets. Without their help we would just not manage. Here then is a list of the extended "Maestro family":

- Wally and his team at **PSG Online Securities** in Pretoria, who are the custodians of most of our segregated portfolios. Wally and his team are an indispensable part of our team and do an enormous amount of work for our clients "behind the scenes;"
- Nicolette at **Investec Securities** who performs a similar function on one large client portfolio;
- The many people we deal with at **Investec Bank**, both in the Private Bank and the Treasury;
- The team at **Prescient**, who administer the Maestro Equity Fund;
- Eddie and his colleagues at **Deutsche Securities** who execute our Maestro Equity Fund deals;
- The team at **Investec Prime Broking**, the prime brokers of the Maestro Long Short Equity Fund;
- The team at **IDS**, who administer the Maestro Long Short Equity Fund and who provided *immeasurable assistance* during the planning stages that led to the establishment of our Fund;
- We appointed **Independent Compliance Services** as Maestro's independent compliance officer in August this year, and welcome Enrique and Jenine into the family;
- The team at **Equity Fund Services** in Luxembourg, who administer Central Park Global Balanced Fund and who are great to work with;
- Renaud and Olivier at **Credit Agricole**, Central Park's administrator, also in Luxembourg;
- Lesli at **Fairheads International Trust Company** in the Cayman Islands. In-between surviving the hurricanes (really!), Lesli helps us in Fairheads' capacity as the Director of Central Park;
- We also recently welcomed on board Etienne and Claudia at **Merrill Lynch** in London, who will in future assist with the execution of the equity transactions on the Central Park portfolio;
- To Dave at **Zero Zero One**, which hosts our website; Dave recently helped us with a major revamp of our site. You can now find the details of all our products, as well as much more on important matters such as our core values and philosophies. If you haven't visited it recently, please do so at www.maestroinvestment.co.za – I welcome any comments you may have;
- To Glen and Sigal of **Compugraphix**, who are the creators and graphic designers of all our brand imaging;
- Then very importantly Tim and his team at **Ralph Stanton**, our auditors, who we called on, inter alia, to deliver all sorts of documents all over the country at short notice this year. Tim also provides guidance and input on many important issues in Maestro's life and has been a great support and resource to us since Maestro's inception more than seven years ago.

And there you were – thinking that we do all the work ourselves from our humble head office in Cape Town! May I again express my gratitude to all these people for your wonderful advice, assistance, friendship and support over many years?

There are four more very important groups of people closely associated with the company that need specific mention: *firstly* to the **Investment Managers** of Central Park's assets in London, Los Angeles and Zurich. They have contributed to the Fund having a good year despite the challenging circumstances. They have provided guidance and support, and have generated many ideas that we have subsequently implemented in the Fund – I am very grateful to all of you. *Secondly*, there are all the "**friends of the company**" as I call them (who promise me that "when their ship comes in" they will become Maestro clients!); the personal and professional friends I meet with regularly to share ideas, throw ideas around, and call on for support at regular intervals. *Thirdly*, there are **our clients**, *without whom Maestro would simply not exist*. It seems trite to say thank you, but I don't ever want to create the impression that we do not appreciate the fact that they have entrusted their assets to us. It is a great responsibility, which we take very seriously (and which is why we are so conscious of the stressful times in recent months). Now is the time to again express our gratitude to them for all their friendship, support and loyalty – thank you so much. And *finally* a great deal of thanks and credit must go to my colleagues in **the Maestro team**, namely Vicki and David and most importantly my wife Sue and my wonderful children, Benson and Josie, for their long-suffering and patience with me through the past year, as well as for providing the inspiration for the stamina required "when times get tough".

I am aware that many reading this letter have, for a number of reasons, also had a hard year. It is my sincere wish that the coming year will bring much blessing and reward to all of you and that you will all have a relaxing holiday and Festive Season. Next year will bring many new challenges – let us use this time wisely as we gird ourselves for all that lies ahead.

Table 2: MSCI Emerging Market Nov returns (%)

	Nov	YTD
EM countries/regions		
EMERGING MARKETS	**-7.1**	**36.1**
Russia	1.8	17.6
Indonesia	-0.2	49.1
Czech Rep	-0.4	48.2
India	-2.0	59.3
Malaysia	-2.6	33.5
EMEA	**-2.9**	**24.0**
Israel	-2.9	30.4
Philippines	-4.6	32.8
Brazil	-4.9	70.7
Hungary	-5.6	12.1
Mexico	-5.7	10.5
LatAm	**-5.8**	**45.2**
Thailand	-6.6	37.9
South Africa	-7.6	19.6
Turkey	-7.6	65.2
Poland	-7.7	25.2
Asia	**-9.4**	**39.1**
Chile	-9.4	22.9
South Korea	-9.5	32.0
Argentina	-10.0	-0.5
Taiwan	-11.2	6.9
China	-13.6	70.7
Peru	-14.4	89.8
EM sectors		
Health Care	-1.2	21.3
Energy	-2.7	44.2
Telecoms	-3.4	49.7
Utilities	-4.2	31.7
Consumer Staples	-5.7	20.9
Consumer Discretionary	-7.5	15.5
Materials	-8.4	62.5
Financials	-9.3	30.4
IT	-9.8	1.4
Industrials	-11.3	70.0

Source: Merrill Lynch